CFA Society United Kingdom

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ESMA
103 rue de Grenelle
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Response to ESMA/2014/175

Guidelines on Alternative Performance Measures

The Financial Reporting and Analysis Committee (FRAC) of the CFA Society of the UK (CFA UK) welcomes the opportunity to respond to the European Securities and Markets Authority (ESMA) consultation paper 'ESMA Guidelines on Alternative Performance Measures'.

CFA UK represents more than 10,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

Introduction

The FRAC broadly agrees with ESMA's guidelines on Alternative Performance Measures (APMs). We believe APMs can be useful but only if they are presented in a fair manner that is not misleading. Ideally, they should be applied consistently across different time periods and between companies, particularly those in a given industry, in order to aid comparability.

Because of the proliferation of APMs, we support ESMA's effort to bring some discipline to the process. This should be done in the context of the IASB's work on the profit & loss account/other comprehensive income and financial statement presentation more generally.

It would also be helpful if ESMA were mindful of the stance of other regulators, e.g. the SEC, on pro forma earnings and the use of non-GAAP numbers to ensure that the guidelines are complementary. Another approach that we have found helpful is that of the UK's Financial Reporting Council in its reminder to boards, on 13 December 2013, of "the need to improve the reporting of additional and exceptional items by companies and ensure consistency in their presentation". [PN108]

Regarding the idea of forcing companies to de-emphasise their APMs, we are not sure this can be legislated for. The documents emanate from the companies themselves, and what they choose to emphasise, or not, tells us something about the management's character. **However, there could be a guiding principle that APMs should not be more prominent than the GAAP measure.**

The guidelines should not be too prescriptive. APMs are employed as part of a company's effort to communicate with investors, giving it some flexibility to explain its specific character and circumstances. Analysts start with the IFRS numbers and apply judgment to the adjustments suggested by management, as well as making their own adjustments.

Main response

Q1: Do you agree that the ESMA [draft] guidelines should apply to all issuers defined as a legal entity governed by private or public law, other than Members State or Member State's regional or local authorities, whose securities are admitted to trading on a regulated market, the issuer being, in the case of depository receipts representing securities, the issuer of the securities represented regardless of the financial reporting framework they use to report? If not, why?
Agree

Q2: Do you agree that the ESMA [draft] guidelines should apply to APMs included in:
a) financial statements prepared in accordance with the applicable financial reporting framework, that are made publicly available, and
b) all other issued documents containing regulated information that are made publicly available?
If not, why?
Agree

Q3: Do you believe that the ESMA [draft] guidelines should also be applicable to prospectuses and other related documents, which include APMs (except for pro-forma information, profits forecasts or other measures which have specific requirements set out in the Prospectus Directive or Prospectus Directive implementing regulation)? Please provide your reasons
Yes they should be applicable to prospectuses. We would expect this to apply to pro forma information and profit forecasts.
We note and support the approach of jurisdictions mentioned in paragraph 18:
"ESMA acknowledges that in other jurisdictions, such as Australia, Canada, New Zealand and the United States, the principles on transparency and comparability that direct the use of APMs are applicable to prospectuses (or filing documents)."

Q4: Do you believe that issuing ESMA guidelines constitute a useful tool for dealing with the issues encountered with the use of APMs? If not, why?
The guidelines will be a useful tool if they bring consistency and comparability to alternative performance measures without encouraging or endorsing their use.
Reconciliation to IFRS numbers is particularly important.

Q5: Do you agree with the suggested scope of the term APM as used in the [draft] guidelines? If not, why?

We prefer the guidelines to be concise and principles-based rather than containing detailed prescription, so we agree with the following description in paragraph 15: "an APM is any numerical measure of historical, current or future financial performance, which relates to the financial position, comprehensive income (including other comprehensive income) or cash flows, other than a measure defined by applicable financial reporting frameworks". This should cover categories referred to in the document as "physical performance" eg sales per sq metre and measures under other disclosure requirements e.g. pro forma information in prospectuses and Key Performance Indicators (such as subscribers, ARPU or churn).

Q6: Do you believe that issuers should disclose in an appendix to the publication a list giving definitions of all APMs used? If not, why?
Yes, clear definitions are very important. We would hope that these would be consistent across reporting periods and similar companies. Any changes should be highlighted.

Q7: Do you agree that issuers should disclose a reconciliation of an APM to the most relevant amount presented in the financial statements? If not, why?
Yes

Q8: Do you agree that issuers should explain the use of APMs? If not, why?
Yes. it is important that companies justify their use of non-IFRS numbers. Many make adjustments without explaining their reasoning other than to say that certain items are non-recurring. Companies should be encouraged to avoid boilerplate. They should explain how and why the APM is more relevant to their circumstances than the IFRS measure.

Q9: Do you agree that APMs presented outside financial statements should be displayed with less prominence, emphasis or authority than measures directly stemming from financial statements prepared in accordance with the applicable financial reporting framework? If not, why?

This is difficult to legislate for and, in any case, ESMA should not assume that investors believe everything management says. The statutory IFRS numbers should be prominently displayed and are usually easy to find. **However, APMs should not be more prominent than the GAAP measure.**

Whatever the presentation, the difference between IFRS numbers and APMs needs to be clearly explained. It should be easy to find a note of what has been excluded from an alternative profit number and a table reconciling the alternative number to IFRS. The key point is to encourage companies only to use APMs that are meaningful, not misleading, and that are consistent across time and between peers.

Q10: Do you agree that issuers should explain the reasons for changing the definition and/or calculation of an APM? If not, why?
Agree

Q11: Do you believe that issuers should provide comparatives and/or

restatements when an APM changes? If not, why?
Yes

Q12: Do you believe that issuers should provide explanations when they no longer use an APM? If not, why?
Yes

Q13: Do you agree that the [draft] guidelines will improve transparency, neutrality and comparability on financial performance measures to users? If not, please provide suggestions.
In general, we believe the guidelines will improve transparency and comparability. However, we are not sure that the need for neutrality is sufficiently clear. Companies are more likely to treat costs or losses as one-offs than revenue or other gains. Preparers of accounts should be reminded that their APMs should be unbiased to avoid the tendency to exclude unusual costs and include unusual income.

Q14: Do you agree with the analysis of the cost and benefit impact of the [draft] guidelines? Please provide any evidence or data that would further inform the analysis of the likely cost and benefits impacts of the proposals.

The costs and benefits to users look sensible. Since many companies already provide explanations and reconciliations, we would not expect preparers to incur high costs in implementing the guidelines, provided they are not too detailed or prescriptive.

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We look forward to discussing the issues raised in this response.

Yours sincerely,

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CFA Society of the UK

Will Goodhart,
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CFA Society of the UK

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.